Reconstruction—and Beyond

Article I—Ultimate Tendencies

General Trend of Commodity Values the Decisive Factor in Transition of Business From War to Peace Basis — Price Level Should Be Held Stable, Despite Clamor of Low Price Advocates and Pressure of Inflationists

(Note.—This is the first of a series of articles in which Professor Davenport will discuss the future of security values, interest, international trade, gold movements, wages, immigration, shipping, taxation, real estate, etc. The second article will be presented next Sunday.—Financial Editor.)

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THERE are a host of questions: What will be the trend of prices, of wages, interest, profits, exports, imports, gold movements, Stock Exchange quotations? What will take place in the line of strikes, of unemployment, of immigration and of taxes? What will be the movement of prices relative to one another?

First of all, doubtless, in point of time is the problem of industrial reconstruction. But consideration of this particular problem will best await the discussion of the larger forces and the more durable movements—partly because of the dependence of each particular analysis on the larger fundamental principles of the long-time movement—partly also because the long-time adjustments will be profoundly influenced by the long-time prospects.

The chief difficulty in discussing any one of these various problems is that all of them will be decided mainly by the general trend of prices. And the general trend in prices will depend more largely on political and legislative policies than on purely economic influences—the economic forces working within a fundamental setting fixed by non-economic forces. The first step, then, is rather one of prophecy than one of economic analysis. And prophecy is especially hazardous here. Accordingly, therefore, as the future financial policies work for stationary or for lower or for higher prices, will all the derivative movements be determined.

What then are the possibilities and probabilities as to general prices?

Particular price movements, changes in prices relative to one another, there will inevitably be, partly as incidental to the change from the war-time organization of industry to a peace-time basis, partly as the result of national policies affecting particular industries and products. But the present and primary problem is the outlook for general prices.

Precisely as in the great and fundamental readjustment to a war basis there were great modifications in general prices, so in the organization of industry for peace purposes great changes in relative prices are inevitable. Not so, however, for the general average of prices—the price level, as it is often called, the movement of general prices.

Everything Dear But Money

Actually, of course, not in America alone, but in the world at large there has been a sharp and general rise in prices. This has been the result of the generally adopted methods of war finance—the failure to preserve a constant ratio betwen the volume of circulating media and the volume of trade. Instead of a policy that should somewhat contract the currency in face of a somewhat diminishing volume of production and exchange, there has been an inflation in thecurrency, the intermediate of exchange, the circulating medium. By making currency extraordinarily plenty it has been made extraordinarily cheap. Prices have risen, not precisely as the result of cheap money, but as the report and expression of cheap money—nothing cheap but dollars.

Whether this was the more a sin than a blunder, whether, indeed, it was either, we need not now discuss. It was easy. The other belligerent nations, perhaps mainly because they had been at war the longer, have carried further the inflation process, and have therefore brought about the greater disturbance of prices. Russia carried the process so far, adopting the direct issue of fiat money, that these issues came to be discredited and the entire system of exchange collapsed. Whatever else may have contributed to precipitate the collapse, the financial policy of Russia must have brought it. Germany and Austria, next to Russia, have most relied on inflation. It was no small factor in Germany's collapse that finally, with a waning confidence in victory, her money system was discredited, that her circulating medium would not circulate and that she was reduced to the direct inflations of paper money issues. Thus Germany was done for, irrespective of the failure of her military campaign. Her enemies needed merely to wait. She was inflating herself into a paralysis of production through a paralysis of exchange. Now she faces not only the problem of what finally to do with her card house of indebtedness incurred by price-raising devices, but what immediately to do to command revenues, and what ultimately to do with the high price level and the disappearance of the exchange media to support it.

America's Problem The Simplest

Thus far the Entente countries have been confronted with no menace of a purely monetary collapse, but only with the difficulties of inflated prices and a derivatively swollen bonded indebtedness. America, as having supported a war during a shorter period and having taxed for a larger share of its war expenses, has by far the simplest problem. But problem it still has—the same in kind, but only smaller in degree. The first of our problems, therefore, having especial reference to the probable trend of prices, will find its solution in the prospective credit and monetary policies—primarily in the world as a whole and therefore derivatively in America in particular. World policies and world prices will finally control America's policies and conditions.

But our problem will be clearer with a short analysis of our possible alternatives in war finance. On the face it would appear possible to finance a war through credit operations without appealing to bankers, and consequently without any increase in the volume of circulating media, and therefore finally without disturbance to general prices. So long as the increasing fund of purchasing power in the hands of the government is obtained through an offsetting reduction in the volume of purchasing power remaining with civilian buyers no inflation takes place. Borrowing out of individual incomes is for this purpose interchangeable with taxation. The only difference refers to the sort of paper, whether receipt or contract, that the contributor receives, and to the future rights and obligations.

But borrowing out of saved incomes is impossible in the degree that is necessary for a great war, excepting on terms of an enormous rise in interest rates. Practically, therefore, it is impossible on any terms. Greatly rising interest rates recapitalize all investments and securities into lower present values and therefore result in countless insolvencies, ending ultimately in a hurricane of panic in the method will not have furnished the funds. Hardly any rate of interest can be offered that would attract funds diverting the war activities two-fifths of the national production—an average restriction of civil consumption to three-fifths of the ordinary level; a temporary fall of two-fifths in the average standard of living. Borrowing at reasonable rates will count for something. But for the remaining revenues the choice lies between taxation and inflation.

We have compromised between the two methods. But in the main we have adopted the inflation method. Still further than ourselves has Europe gone in this direction. High world prices are the result—high prices for us, still higher for Europe. What now is to be done?

The penalties of inflated prices are many and serious. Powerful interests that have been grossly wronged in these war years—creditors in general, inclusive of bondholders, insurance policy holders, savings banks, receivers of fixed incomes and public utilities companies—all will call shrilly for restitution through the deflation of prices. Both here and abroad the millions of holders of tens of billions of the new war debts will urge that their cheaply bought bonds be reinstated into the purchasing power of the pre-war dollar. Both justice and injustice will clamor for lower prices. The common man also, war weary and price ridden, will demand that the "cost of living" be reduced. England and France, with their conservative traditions of gold redemption, will be predisposed toward the prompt abandonment of their irredeemable money—the reëstablishment of gold payments.

The arguments are many, the interests powerful, the demand insistent. There is danger that the thing may be done. On the whole, however, it ought not. Even if we learn it over-late, we must nevertheless learn that every new disturbance of general prices, whether a marking up or a marking down, is a new error—not so much the righting of old wrongs as the creating of new. If rising prices are bad as an essential violation of the obligations of contract, a tampering with the standard of agreements, falling prices are not less bad—the same thing in the reverse direction. But of the two evils falling prices are the worse. I shall, I trust, make this clearer in other connections. It must suffice for the present to urge that atonement for our past unwisdoms in price disturbance is impossible. The wise thing now, and the sole wise thing, is to hold prices stable against the urgency of the low price advocate equally with the further pressure of the inflationists. Whatever is done will, however, be decisive as to most of the further problems. Discussion of these, therefore, will have to proceed on each one of the three possible assumptions: (1) a falling of general prices, (2) rising of general prices, (3) stable general prices.

I believe, however, that the actual working out of the policies of the nations will be diverse—that England and France will attempt to retrace their steps, substituting for the first error of credit inflation the new and reverse error of deflation.

Danger of Divergent Policies

It is, however, possible that the policies of Europe or America may diverge. In this there is by far the greater danger for America. If further inflation takes place it will probably be with us. England and France are already deeply enough in debt. Their bank portfolios are stuffed with government obligations. If they borrow at all it will probably be with us. Russia certainly—and the Central Powers probably—have gone so far in monetary abuses as to have discredited their medium of exchange. If so, their paralysis of exchanges will involve industrial paralysis. They must begin over again. There is no menace of further inflation from them. Instead, our first problem may be to supply them with the metallic basis for a new currency system. Producing little or nothing, they will for a time sell us little. Spent in credit, they will obtain neither money nor goods from us, but by charity grants. They offer us, in truth, an excellent opening for the surplus reserves that now constitute our own menace of inflation.

But if England and France move toward deflation we shall find stability of prices difficult to maintain here and any further inflation of prices essentially hazardous. If England and France desire to get back the gold they have unwisely released to us—to our harm as well as to their own—they must do it either by borrowing or by making their prices lower than ours, by selling to us more than they buy from us. They will have the goods for sale. They need merely to liquidate their expansions—contract their loans—require the cancellation of their deposit liabilities in the reduction of their portfolios—and prices will respond in fall, as they responded in rise to the earlier policy of expanding deposits through expanding bank accommodations. England and France can get back to gold redemption if they try—if their central banking institutions require it, or if the legal suspension of gold redemption is repealed. They will get our gold in the process of contraction. In this process they will have established redemption. Any further expansion of credit and of prices on our part will merely facilitate the process for them, and will come to its limit through the progressive and dangerous depletion of our gold reserves.

The policy of England and France is then mainly a matter of surmise, of probability. Deflation is not difficult merely as a process, no matter how disastrous in its working and how unjust in its effects. But if they attempt it we shall have to go along with them or abandon the gold standard the while that they are establishing it. We cannot keep our gold—even what we ought to retain of it—at a level of prices higher than theirs. Stimulated imports and retarded exports would take it from us, precisely as stimulated exports and retarded imports have brought it to us. We must go along with the rest of the world, under the penalty of stopping trade or of forsaking the gold standard. The whip hand in the command of gold is always with the low price country.

The Only Way to Escape Expansion

Nor is it easy to make certain of what our price policy will actually be. Primarily our difficulty is one of surplus reserves, under banking institutions that are still competitively separatist and only partially centralized; secondly, in the fact that the Reserve Association, like the separatist bankers, is mainly concerned with keeping its reserves employed and making all the dividends it can. Otherwise than through legal modifications of the reserve requirements of the banks and in the rediscount policies of the reserve boards there would appear to be no escape in America from a course of further expansion. Possibly in order to get gold from us—certainly to get goods from us— our credit facilities are to be enormously solicited by foreign suitors. We shall then probably continue our expansion until we reach the danger border of acute contraction. Consequently, whatever are the immediate and temporary phenomena of peace readjustment, we are likely to experience a further rise in prices, even though it is still true that we need not, if only we will do the necessary things in the way of prevention.

What, then, the probable inflation policy will mean—what in turn the possible policies of stability or deflation may mean with relation to profits, dividends, wages, interest, foreign trade, security markets, unemployment, strikes, industrial friction, taxes, and the intervening and temporary readjustments incidental to the coming of peace and so on, must be the subject matter of further analyses. First, however, in the order of discussion will be the intervening and temporary readjustments.

Experience of Europe's Bourses Basis of New Plan

Stock Exchange Clearing House Development as Adopted by Governors Is Designed to Save Labor

IN ADOPTING a new clearance system which will include both securities and brokers' loans, the governing committee of the Stock Exchange announced that the new plan was approved after an exhaustive investigation of the clearing methods employed on the European stock exchanges. S. F. Streit, chairman of the special committee of five which drew up the plan, conducted that investigation, and in his travels visited the bourses of London, Paris, Vienna and Berlin. In a special report to the local Stock Exchange authorities Mr. Streit said:

"The volume of business and conditions in New York are such as to make it unwise to inaugurate a system as complete in many ways as those already in operation in Europe, but the plan submitted is based on fundamental principles that have proved sound through over twenty years of use abroad, and is capable of being largely expanded."

In effect, under the present system of clearance here each exchange member delivers a sheet on which is recorded his sales and purchases of active securities. It has been the task of the clearing house to reconcile all deliveries between different parties and to adjust the cash differences by either paying or receiving the balances due, so that as little money may be required in the settlement as possible. Under the new plan brokers' loans also will be cleared.

Mr. Streit found that the first well authenticated system of clearing intermediate contracts of securities was established in Frankfort, Germany, in 1867, although there had been systems in vogue on less complete lines in Glasgow, Scotland, and Manchester, England, from as early as 1848. After the establishment of a clearing system in Frankfort clearing houses were adopted by Berlin, Paris and London within ten years, and it was from these methods that data were secured on which the New York Stock Exchange clearing house was started in 1892, following a request by the banks that the exchange find some way of reducing stock brokers' day to day loans.

Clearing House Saves Labor

Many changes in detail had to be considered, owing to the system of daily settlements here, but the fundamental principles remained, and, as Mr. Streit puts it, "the clearing house has proved to be of great value in saving labor and reducing the demand on banking facilities."

In Paris, Berlin and Vienna, he asserts, the functions of the clearing houses have been developed further than heretofore considered possible in New York, involving the principle of offsetting debits and credits, both of money loans on securities and clearing house stock balances, together with the receipt and delivery of all securities at a central institution.

Of these methods, that in Paris is the simplest, while in Vienna the centralization of control was found to be much greater, which was made possible by the fact that banking institutions, both in their capacity as loaners of money and dealers in securities, were members of the Bourse and members of the clearing house, as well.

The so-called settlement department of the London Stock Exchange clears for about 1,200 firms, representing approximately a membership of 4,000, and in fair business markets about 800 to 1,000 firms actually send in sheets, the settlements of brokers' loans being fortnightly. The routine of settlement comprises four days, the first being mining settlement day, the second for "bearer" stock and other securities; the third day is the one on which tickets for clearing are passed, and the fourth day is pay day, when the balances of securities are delivered and paid for.

"It is not customary," says Mr. Street, "in London for brokers to have checks certified by the banks in payment for securities, as here, and the margin on loans required by the banks for the fortnightly period averages about 10 points, instead of the usual 20 per cent demanded here. As registered stocks can only be delivered by transfer and the tying up of these for large amounts when only a part thereof has been sold might cause a burden, there is connected with the Stock Exchange what is known as the 'share and loan' department, which receives certificates from the seller for transfer that have been sold, and, by certifying to that effect on the transfer deeds, enables a delivery to be made while the stock is in process of transfer.

Agents de Change In Paris Have Partners

"The Bourse proper in Paris consists of seventy members, known as 'agents de change,' who have enjoyed special privileges in connection with trading in securities since the fourteenth century. At times the price of the privilege of being an agent de change has gone as high as $400 000, but in 1914 it was valued at about $300,000. In addition, the agent de change must furnish a cash bond of $50,000.

"Although the majority of the members are well to do, they are not usually able to provide the means for the bond and the purchase and the necessary working capital. Generally, therefore, they combine with other capitalists, who become silent partners of the business and are termed 'partners,' although assuming no rights or obligations to third parties, but only to the agent de change himself.

"Because of the large amount required to be paid for seats on the Bourse, most of the agents de change are not called upon to both pay the same and furnish the necessary capital for the business, but have partners.

"The trading of the agents de change is so circumscribed by regulations that there is less interest in it in comparison with that of other countries.

"Trading on parts of the floor of the Bourse not allotted to the agents de change, as well as on the porch of the building, are two associations of outside brokers, known as 'Coulisse.' One set trades entirely in securities for cash or immediate settlement and the other for term settlements, which are fortnightly for French rentes and monthly for other active securities.

Booze in Boerse At Berlin a Factor

"An interesting feature of the Boerse in Berlin was the presence in a room directly off it of a complete bar, where beer flowed freely. This was even more noticeable in Vienna, where a bar for the sale of beer and other beverages was directly on the floor of the Boerse, and in both cases barmaids were in attendance.

"The operation of the Vienna Boerse and its associated institutions is on a smaller but even more perfect scale than in Berlin. Apparently it was the first and only market to show positive reflections of the war as early as March, 1914, as during the latter part of that month there were violent declines on the Boerse, continuing at different times over different periods, and entirely out of proportion to any effects noted on the other markets of the world. In the latter part of March, 1914, rumor was positive on the Vienna Boerse that the Russian army was being mobilized, and definite and concrete statements appeared regarding an antagonistic state of affairs between the Austrian and Serbian governments."

Why Stimulate Gold Production When the World Needs Less Money and More Goods?

Proposal to "Do Something for Gold," if Adopted, Would Make the Metal Cheap and Inevitably Result in Another Boost in the High Cost of Living, Thus Causing Widespread Discontent

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FROM 1873 to 1893 the gold price of fine silver per ounce fell from $1.30 to 64 cents. A number of our Western states in which silver mining was an important industry were greatly disturbed over this decline, and they instituted a vigorous campaign, demanding that the government "do something for silver." This demand was the chief force leading to the passage of the Bland-Allison act in 1878 and the Sherman purchase act in 1890. It was an important factor in the campaign for national bimetalism, under the leadership of Mr. Bryan. We are now confronted with a similar agitation, emanating from the same mineral producing regions, only this time it takes the form of a demand that the government "do something for gold."

The argument as it is usually advanced is well expressed in the preamble of a resolution submitted to the American Bankers' Association at its recent annual convention in Chicago the last week of September. This preamble, in part, follows:

> Whereas, the gold production of the world is rapidly decreasing, having declined from $469,000,000 in 1915 to $130,000,000 in 1917 as the world's output. Of this decrease, the United States declined from $101,000,000 in 1915 to $84,000,000 in 1917, and it is predicted by those conversant with the facts that the decrease in the United States this year will be much larger in proportion, it being estimated by government officials to be $11,000,000, based upon the production for the six months ended June 30, 1918.
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> Whereas, this decline in production is due entirely to the fact that the cost of producing the gold ounce as a commodity has exceeded the fixed price of 20.6718 per ounce; and,
>
> Whereas, the only form of relief that will prove effective and can be applied promptly is action by the United States government in such form and by such methods as may be deemed fit and proper under the circumstances; and,
>
> Whereas, gold is the standard of value and the basis of all credit, and is vitally important to the financial and commercial life of the nation and of the world; and,
>
> Whereas, the Secretary of the Treasury of the United States has stated that, next to food and ammunition, gold is the one most needed war essential . . .

What Has Been Proposed

From premises such as these the conclusion is drawn that the United States government should "do something for gold." A number of plans have been suggested, but the two that have received most favor are (1) that the government buy all new gold presented to it at a substantial premium over its present fixed price, namely, $18.60 per ounce of American standard gold .900 fine, or (2) that the government give the producers of new gold a bounty in proportion to the amount of gold produced. Milder forms of government assistance have also been suggested, either to be used alone or as supplementary to stronger forms.

These proposals are apparently finding favor in high places. An American gold conference was held at Reno, Nev., the fore part of August, and similar conferences have since been held at Portland, Ore., and Spokane, Wash. These conferences all favored government aid to gold mining.

A committee appointed by Secretary Redfield is now making a study of possible methods of stimulating gold production. Secretary McAdoo recently appointed a special committee "to study carefully and thoroughly all the difficulties confronting gold production" and to "submit sane and sound methods of relief." "The Commercial and Financial Chronicle," our best known American financial weekly, in its issue of September 28 favored government aid to gold mining. The American Bankers' Association in national convention in Chicago the last week in September passed a resolution to "respectfully request and urge upon the government of the United States the desirability of maintaining the production of gold to at least its pre-war volume and ask that steps be taken immediately to that end."

In England also the subject of "doing something for gold" is being agitated. The British Treasury has appointed a commission to investigate "the war's effect on gold production in the British Empire," and the commission's instructions call upon it, among other things, to suggest a plan designed to show how the production of gold can be stimulated.

Proposals with support like the above must be taken seriously.

One-Third of Output For Use in Arts

Of the world's annual gold production, part goes into the arts for the manufacture of jewelry, plate, etc., and part into monetary uses. Estimates differ as to the proportions of the net annual production of gold that go into these two groups of uses; namely, merchandise uses and monetary uses. For a normal year probably about one-third of the world's new gold goes into the art and two-thirds into monetary uses.* The proportion of America's annual gold product that goes into the arts is probably somewhat larger normally than the proportion of the world's gold product so used. For 1913 the United States Director of the Mint estimated the net amount of new gold bullion used in the arts to represent 42.2 per cent of the total gold produced in the United States. For 1914 he estimated it to represent 36.6 per cent.

For the past six years the annual gold production of the world and of the United States by calendar years has been as follows, according to the figures of the Director of the Mint.

	World. Millions of dollars.	U. S. Millions of dollars.	Percentage of total represented by U. S. production.
1912	466.1	93.5	20.1
1913	459.9	88.9	19.3
1914	455.7	94.5	20.7
1915	468.7	101.0	21.6
1916	457.0	92.6	20.3
1917	429.0	84.0	19.6

Under the pressure of war economies there has probably been a great falling off in the proportions of the world's new gold produced since 1914 that have annually gone into the arts. This curtailment has probably much more than compensated for the small reductions that have taken place in the world's annual production of gold. This in itself would mean a more than normal increase in the amount of gold going into the monetary uses. Furthermore, widely heralded patriotic appeals in belligerent countries have led to the turning over to the government for monetary uses substantial quantities of gold in the form of jewelry and other ornaments.

Gold Price Never Varies

In the United States there has probably been a falling off in the consumption of gold in the arts since we entered the war. The government, moreover, has taken action greatly curtailing the supply of gold available for use in the arts. These are not times to permit the tying up of labor and capital in the production of gold jewelry and plate on any considerable scale. A reduction of one-half in our normal peace time consumption of gold in the arts would release enough gold for the monetary uses to much more than compensate for the decline in American gold production that has taken place since the war broke out.

Let us now pass to a brief consideration of the proposal to stimulate the production of gold for monetary uses.

Assuming the maintenance of the gold standard, gold is the only commodity in America whose price never changes. If the supply of potatoes, copper, steel, or anything else decreases relative to the demand, their prices rise. If, on the other hand, the supply increases relative to the demand, their prices fall. No so with gold. If the gold supply of the world, or the gold supply of the United States under its present gold embargo, should suddenly be multiplied five-fold, the price of an ounce of American standard gold would still be $18.60, while if the production of gold in the United States and its importations should suddenly be stopped, the price of gold per ounce would not advance one iota. The reason is obvious. We are on a gold standard, and our mints will coin freely all gold brought to them at the rate of 25.8 grains of gold .900 fine to the dollar. At any United States mint 258 grains of gold .900 fine can be sold for $10, while a new ten-dollar gold piece when melted down yields gold bullion to the amount of 258 grains .900 fine. The bullion and the coin are practically equivalent in value because they are interchangeable without appreciable expense to the owner. Our unit of value, the gold dollar, is 25.8 grains of gold .900 fine when minted into American coin, and all of our different kinds of money are maintained at a parity with this gold dollar. Therefore anything that affects the value of gold affects the value of the dollar, and no matter how much gold is produced, or how little, no matter how large a proportion of our payments are made by means of bank checks and bank notes, or how small, the price of 25.8 grains of gold .900 fine at the mint is $1 and the price of an ounce of standard gold is $18.60.

But to say that the price of gold in the United States does not change is not to say that its value does not change. The market value of gold, like the market vaue of any other commodity, is expressed in its command over goods, namely by what it will bring in the market in exchange for other goods. While the producer of gold unlike the producer of any other commodity in America can always count upon a fixed price for his product regardless of how much he produces or how little, he cannot count upon fixity in his expenses of production.

The more gold that is thrown on the market relative to the demand, the less valuable gold becomes in relation to other goods and the higher the price level for other goods rises. An increasing supply of gold on the market relative to the demand does not reduce the price of standard gold below $18.60 an ounce, but it tends to push up the prices of everything that the gold producer must buy, plant, machinery, tools, zinc, copper, cyanide, etc. This rise in the expenses of production is the natural economic force that comes into play to discourage excessive gold production, just as a decline in price is the natural economic force to prevent an excessive production of things other than gold. Rapidly rising prices in a gold standard country are an expression of the renunciation of the gold monetary unit. In the United States they register the fact that the market value of the gold dollar, namely its purchasing power over other kinds of goods, is rapidly declining. Dollars of rapidly declining purchasing power are dollars whose supply is increasing faster than the demand, for the market value of dollars, like the market value of everything else, is a resultant of the forces of demand and supply.

Steady Decline in Purchasing Power

The purchasing power of the gold dollar in the United States has been declining almost continually since 1896, and this decline has found expression in the rising cost of living, which has agitated the public mind for the last twenty years. If one measures the market value of the gold dollar by its purchasing power over the two hundred to three hundred commodities whose wholesale prices are covered by the index number of the United States Bureau of Labor Statistics, and if one calls the dollar of 1896 (the year when the present upward movement of prices began) a 100 per cent dollar, then the dollar of 1913 was a 67 per cent dollar and that of August, 1918, was a 33 per cent dollar. The depreciation of the dollar has been particularly striking since the war broke out, its purchasing power over wholesale commodities having been cut in half since July, 1914, and its purchasing power over retail commodities, such as constitute about 80 per cent of the average laboring man's family budget, having been cut down about one-third (1). Never before in recorded history would an ounce

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*See on this subject André Touzet: Emplois Industrieles des Metaux Précieux, Paris, 1911, pp. 116-128.